

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-130439-06

Date:

October 03, 2006

LEGEND

X =

Shareholders =

Partnership =

Plan =

D1 =

D2 =

D3 =

D4 =

State =

Dear :

This letter responds to a letter dated June 8, 2006, and subsequent correspondence, written on behalf on X, requesting rulings under §§ 1362(b)(5) and 1362(f) of the Internal Revenue Code.

Facts

X was incorporated under State law on D1. On D2, X's shareholders intended for X to be an S corporation effective D1. However, X's Form 2553, Election by a Small Business Corporation, was not timely filed and failed to contain consents from all shareholders of X as required under § 1362(a)(2).

On D3, X issued stock to Plan and Partnership, an ineligible S corporation shareholder. On D4, X cancelled the stock issued to Plan and Partnership and returned their capital contributions.

X requests a ruling under § 1362(b)(5) that it will be treated as an S corporation effective D1 and rulings under § 1362(f) that the effects of X's invalid § 1362(a) election will be waived and that the issuance of stock to Partnership constituted an inadvertent termination.

X represents that its invalid election and subsequent termination were inadvertent, unintended, and not the result of tax avoidance or retroactive planning. X and its Shareholders have consistently treated X as an S corporation and agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

Law and Analysis

Section 1361(b)(1) defines the term "small business corporation" to mean a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(a)(1) provides that a small business corporation may elect to be an S corporation.

Section 1362(a)(2) provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1362(b)(1) provides that an election under § 1362(a) is effective for the current taxable year if it is made during the preceding taxable year or on or before the 15th day of the third month of the current taxable year.

Section 1362(b)(3) provides that an election made after the 15th day of the third month of the current taxable year is treated as having been made for the following taxable year.

Section 1362(b)(5) provides that if an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)), after the date prescribed by § 1362(b) for making the election for the taxable year or no § 1362(a) election is made for any taxable year, and the Secretary determines that there was reasonable cause for the failure to timely make the election, then the Secretary may treat the election as timely made for the taxable year and § 1362(b)(3) shall not apply.

Section 1362(d)(2)(A) provides that (A) an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation, and (B) any termination under § 1362(d)(2) shall be effective on or after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation is not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation is a small business corporation, or to acquire the required shareholder consents, (4) and the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that, for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Conclusion

Based on the facts submitted and representations made, we conclude that X has established reasonable cause for failing to timely make an S corporation election. Thus, we conclude that X is eligible for relief under § 1362(b)(5). In addition, we conclude that

X's intended S corporation election was ineffective because the election did not contain consents from all shareholders of X. We further conclude that the ineffectiveness was inadvertent within the meaning of § 1362(f). Moreover, had X's S corporation election been valid, it would have terminated when X issued stock to Partnership, an ineligible shareholder. We conclude that the termination would have been inadvertent within the meaning of § 1362(f).

Accordingly, under § 1362(b)(5), if X makes an election to be an S corporation by filing with the appropriate service center a completed Form 2553 that contains the proper consents with an effective date of D1, within 60 days following the date of this letter, the election shall be treated as timely made. A copy of this letter should be attached to the election.

Under § 1362(f), X will be treated as an S corporation from D1 and thereafter, provided X's S corporation election is not otherwise terminated under § 1362(d) (except as noted above). Accordingly, all Shareholders of X, in determining their respective income tax liabilities, must include their pro rata share of separately and nonseparately computed items of X as provided in § 1366, make adjustments to stock basis as provided in § 1367, and take into account any distributions by X as provided by § 1368.

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation for federal tax purposes.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

/s/

Mary Beth Collins
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes